# Economic Trends

## Economic outlook weakens

*This edition of Trends is taken from the First Quarter Fiscal Update and Economic Statement, released on August 31, 2015. This month's inFocus provides an overview of current developments in the global economy.*

The Alberta economy is being hit by low oil prices. Real GDP is now expected to contract by 0.6% in 2015, down one percentage point from the March forecast. The revision stems from weaker-than-expected household consumption, investment and exports (Figure 1). The downturn is forecast to be more protracted than previously expected, with weakness carrying into 2016. Growth in 2016 is now forecast to be 1.3%, down 0.4 percentage points from the previous forecast.

External conditions have weakened since March with another flare-up in the Greek crisis and the recent stockmarket crash and currency devaluation in China. This has weighed on oil prices and heightened uncertainty about the outlook for the Alberta economy. Canada's economy has also slowed substantially since the oil price drop.

### Business Sector

**Oil prices remain depressed**

After remaining steady around US$60/bbl for most of the second quarter of 2015, WTI has once again tumbled below US$50/bbl. The forecast for WTI remains near the March forecast for this fiscal year. The light-heavy oil price differential has narrowed this year, as strong demand for heavy oil, unplanned supply outages and increased market access have supported heavy oil prices. While the differential has widened again recently due to refinery disruptions, these effects are expected to be temporary. The 2015-16 WTI-WCS differential forecast has been adjusted down to US$13/bbl. The outlook for natural gas prices has weakened, with the Alberta Reference Price expected to average $2.60 /GJ over 2015-16.

**Oil investment down sharply**

The sharp decline in oil prices has substantially reduced capital spending in the energy sector. Oil and gas investment is expected to fall over 30% in 2015, with weakness carrying into 2016. Conventional investment has been hit especially hard. Rig activity has declined almost 50% through the first seven months of 2015. As a result, the 2015 forecast for conventional investment has been revised lower. Oilsands investment is expected to fall by less than conventional, as projects started prior to the price drop continue to move ahead. Outside the energy sector, non-residential construction activity has held up, supported by institutional and government building. Overall, non-residential investment is forecast to fall 18% in 2015, almost 2 percentage points lower than expected in March.

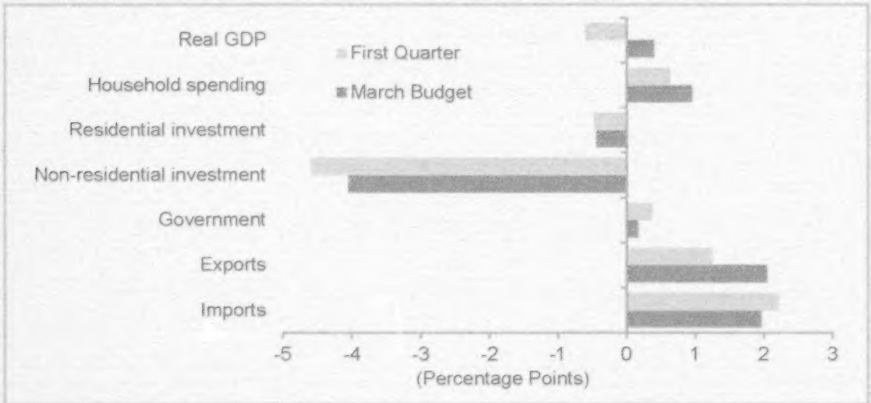
**Business activity slumping**

Lower oil prices are weighing on production and exports. Although exports remain an important driver in Alberta's economy, the forecast for oil production has been revised lower since March. This mainly reflects unplanned disruptions in oil sands production and the significant slowdown in conventional drilling. In addition, weakness in the oil and gas sector has spread to other sectors of the economy. Alberta machinery manufacturing has fallen 20% since January. This can be mainly traced to declining industrial machinery and equipment manufacturing, which primarily serves the oil industry. Agricultural exports are also expected to fall in 2015 as drought conditions have adversely affected farm production. Overall, real exports are expected to grow 2.3% in 2015, down 1.5 percentage points from March. The 2016 forecast is largely unchanged at 3.0%.

**Corporate profits decline**

Lower prices are expected to reduce corporate profits by about 50% in 2015. The decline in revenues has caused oil producers to look for cost savings, further eroding profits and margins for suppliers to the oil sector. Weakness is expected to carry into 2016, with corporate profits recovering

Chart 1: The outlook for the Alberta economy has weakened since March
Contribution to the 2015 real GDP growth forecast for Alberta




**Sources:** Treasury Board and Finance

by 17% in 2016, down from the March forecast of 27%.

### Canadian dollar softens

The Canadian dollar has weakened recently as commodity prices declined and the US dollar strengthened. It lost further ground when the Bank of Canada lowered interest rates by 25 basis points to help stimulate the Canadian economy. The Bank also lowered its forecast for Canadian real GDP, as low oil prices have slowed activity more than expected. The exchange rate forecast for 2015-16 has been lowered by 2 cents to 79.5 US¢/Cdn$.

## Household Sector

### Employment forecast on track

The labour market has been fairly resilient amid the sharp decline in oil prices, with employment holding near the December 2014 level. As a result, the forecast for employment growth in 2015 has improved slightly to 0.8%. There are signs, however, that the labour market is weakening. Employment growth has steadily declined, the number of jobs available has dwindled, and the unemployment rate jumped to 6.0% in July (Figure 2). Labour markets are expected to weaken further in the second half of the year and into next year. The 2016 labour outlook remains largely unchanged from March: employment is expected to grow a modest 0.8% in 2016, with the unemployment rate averaging 5.9%.

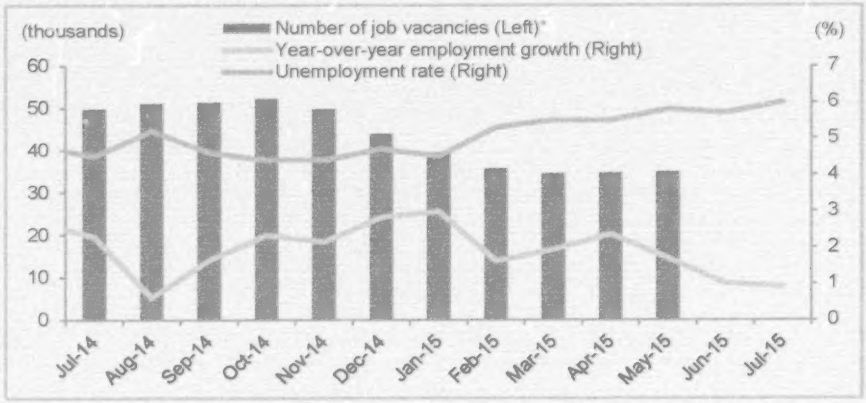
### Earnings growth slows

Earnings have been slumping alongside employment. Year-over-year growth in average weekly earnings (AWE) slowed to only 0.2% in May, and is now up only 1.8% year-to-date. Primary household income, a driver of personal income tax, is expected to grow by just 2.5% in 2015 and 3.3% in 2016. This is down markedly from the nearly 8% average growth over the last 4 years.

### Households curtail spending

Weak labour markets and uncertainty about the economy have prompted households to restrain spending more than expected. Retail sales have fallen 2.1% year-to-date, pulled down by lower gasoline prices and vehicle sales.

Chart 2: Labour market conditions have softened
Alberta labour market indicators




**Source:** Statistics Canada
* Latest Job Vacancy statistics are for May

Consumer spending is still expected to add to real GDP growth in 2015, but by less than previously forecast. CPI inflation has evolved as expected, averaging 0.8% year-to-date, and on target for the forecast of 0.9% inflation in 2015.

### Mixed housing performance

The new and resale housing markets diverged through the first half of 2015. The economic downturn and ongoing uncertainty hindered resale housing across Alberta, especially in Calgary. Sales of existing homes in the province dropped sharply in January and remain 21% lower than last year. In contrast, residential construction has been a source of strength in the Alberta economy, carrying momentum from 2014. Housing starts have been buoyed by multi-unit construction, while single starts have declined. Residential permits, however, suggest momentum is slowing, with housing construction expected to be substantially weaker in the second half of 2015. Housing starts are forecast to be 33,600 in 2015, declining to 29,800 in 2016.

### Migration continues at slower rate

Population growth has been resilient, with people continuing to move to the province despite the slowdown. Alberta welcomed 7,723 people from outside the province in the first quarter of 2015, as positive interprovincial migration offset losses of non-permanent residents. While net inflows remain positive, they have slowed from the record pace set in 2013 and 2014. The forecast for 2015 population growth is unchanged at 2%.

## Risks to the outlook

Risks to the Alberta economy remain elevated, reflecting uncertainty about the path of oil prices and global economic conditions.

- The main risk is a prolonged period of low oil prices stemming from an oversupplied market. Should oil prices fail to improve, the Alberta economy could face prolonged weakness.
- Increased uncertainty about the economy could further erode consumer and business confidence, reducing spending.
- Lower-than-expected population growth would put downward pressure on housing markets and consumer spending.
- On the upside, a sudden improvement in oil prices would improve Alberta's outlook.

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# inFocus

## Global economic uncertainty remains elevated

The current global economic outlook is uncertain, with strands of strength and weakness. Recent events in China have raised concern about its slowing growth, while the economic outlook in Russia and Brazil is bleak. The Eurozone has managed to restore tepid growth after staving off an economic collapse in Greece. Across the Atlantic, Canada's economy has slowed while the US is showing signs of improvement. In addition, inflation around the globe has weak despite the loosening of monetary policy by numerous central banks. The weakening outlook led the IMF to downgrade its July forecast for global economic growth to 3.3% for 2015.

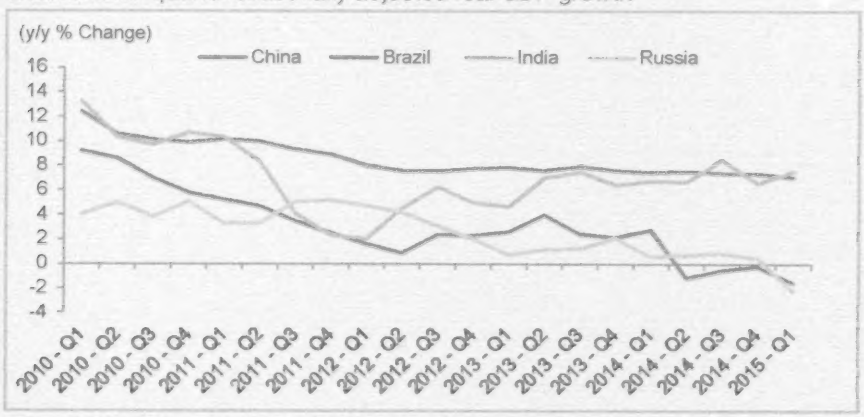
### Turbulence in China's economy

The outlook for China has gradually weakened, despite several government interventions and stimulus programs. China's industrial production and exports have been steadily slowing, while the housing market continues to soften. The recent stock market bubble and subsequent crash prompted the government to announce a slew of back-stop measures to stem the rapid depreciation of equity prices on the Chinese stockmarket. The weakening outlook led the People's Bank of China to devalue the Renminbi by 1.9% in the hopes of stimulating growth by boosting exports. China expected to be a growth leader this year; however, recent events are casting doubt on China's ability to meet the expectation of 7% growth in 2015.

### Other emerging markets mixed results

The performance of other emerging markets so far this year has been variable. India has seen a pickup in growth, aided by an ambitious reform program being implemented by the new government. The initiatives include attracting foreign investment and deregulating the manufacturing sector. India is poised to overtake China as the world's fastest growing economy, with real GDP expected to reach 7.5% for 2015. The other BRIC economies of Brazil and Russia are each in a recession (Chart 1). Weighing heavily on Russia's economy are continuing sanctions, low oil prices and the 45% (y/y) Ruble devaluation. Brazil's economy is struggling with weak commodity prices and a political corruption scandal. Commodity exporting emerging markets in Latin America like Chile, Columbia and Mexico have also been hampered by low prices, while growth in the Middle East and North Africa has been halted by ongoing geopolitical conflicts. Conversely, several East Asian markets such as Thailand and Indonesia have shown resilience, sustaining robust economic growth year-to-date.

**Chart 1: India avoids slowdown afflicting other key emerging markets**
Quarter-over-quarter seasonally adjusted real GDP growth




**Source:** Instituto Brasileiro de Gegrafia e Estatistica, China national Bureau of Statistics, Central Statistical Office of India, Federal State Statistics Service

### Tentative Eurozone recovery

The Eurozone economy continues to struggle, although growth prospects have improved for the previously struggling economies in France, Italy, Spain, Portugal and Ireland. Staving off Greece's debt crisis bolstered the outlook, while economic uncertainty from conflict in the Ukraine has eased. The German economy is the Eurozone's largest and an important driver of growth; Germany's industrial production, private sector consumption and exports have picked up after a sluggish 2014. After flirting with deflation, Eurozone inflation remains low but has accelerated with the help of the ECB's Quantitative Easing program and a devalued Euro. However, the Eurozone economy has yet to surmount an array of challenges including pervasive unemployment and waning productivity. Outside the Eurozone, the UK has been a bright spot among European economies, with real GDP growing by 2.6% over the past four quarters.

### Japan's woes reemerge

Weak consumer spending and exports have weighed on Japan's economy recently, causing real GDP to contract by 0.4% in the second quarter as inflation dropped below 0.5%. This follows a series of reform and stimulus initiatives that supported a pick-up in growth and inflation in late-2014 and

the first quarter of 2015. Japan's economy is now expected to eke out 0.8% growth for 2015.

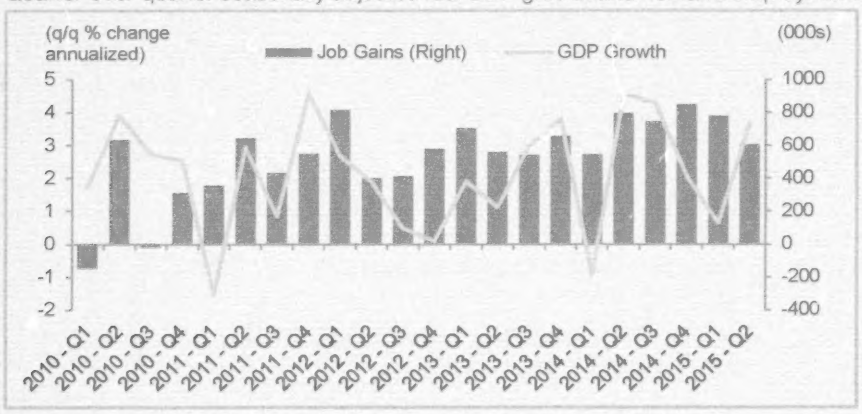
### US getting back on track

The US economy is gaining momentum, as headwinds that suppressed growth in the first quarter have faded (Chart 2). Real GDP picked up to 3.7% in the second quarter and is forecast to reach 2.5% this year. Consumer spending, which accounts for roughly 67% of US GDP[1], contributed strongly to growth in the second quarter. The labour market has created an average 211,000 jobs per month since January 2015, and broader indicators like long-term unemployed and average duration of unemployment have markedly improved. However, impediments remain in the US economy. Despite a pickup in consumer spending and labour markets, inflation has remained tepid. The US dollar has appreciated by 20% against other key currencies. This, along with weak global demand, has encumbered exports. With a healthier labour market, the US Federal Reserve signaled its desire to begin gradually raising the federal funds rate later this year. However, the uncertainty pervading the global economy may delay the Fed from raising interest rates this year.

1 See "US Consumers at the Helm" for a more detailed discussion about the American consumer sector. *Trends/Infocus - Alberta Treasury Board and Finance (April, 2015).*

**Chart 2: US economy showing strength and creating jobs**

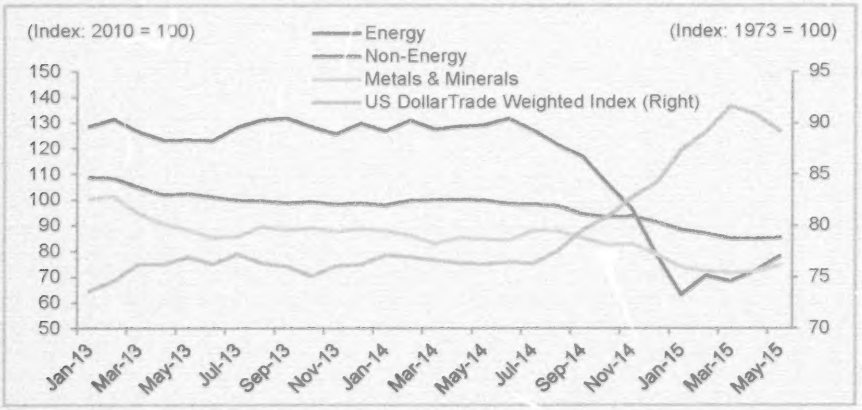
Quarter-over-quarter seasonally adjusted real GDP growth and nonfarm employment




**Source:** US Bureau of Economic Analysis, US Bureau of Labor Statistics

**Chart 3: Commodities prices fall while Greenback gains**

Select commodity price indicies and USD vs major currencies




**Source:** World Bank and Federal Reserve Board

### Declining commodity and equity prices

Renewed uncertainty about the trajectory of global growth, especially in China, and the strengthening US dollar have depressed commodity prices (Chart 3). Base metal prices have fallen in tandem with slowing growth in China, while energy prices remain low as supply growth continues to outpace demand. After a short lived rebound, oil prices have retreated. China's stockmarket crash and weakening outlook reverberated through major global stock markets, with equity indicies like the S&P 500, Nikkei and TSX erasing year-to-date gains for 2015 in less than a week in mid-August.

### Canada's outlook dims

Under the backdrop of low oil prices, Canada's economy contracted in the first five months of 2015. In the first quarter, business investment in non-residential structures fell 20% (annualized) and equipment fell over 7%, hit hard by cutbacks in the oil and gas sector. Exports grew by a meagre 0.2% (q/q). The Bank of Canada lowered its growth forecast and cut interest rates twice, in January and then in July 2015, to mitigate the downturn.

A lacklustre labour market, highly leveraged households, low commodity prices, a weak energy sector outlook and weak global demand are expected to weigh on Canada's economic prospects in the near term. This has contributed to a weakening Canadian dollar, which has depreciated by over US15¢/Cdn$ over the past year.

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